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The Final Days of the 105th Congress:

An Overview of Achievements & Unfinished Challenges

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The final days of the 105th Congress are indeed tumultuous times. Uncertainty is the coin of the realm. It is with much trepidation then, that I attempt to provide this forum with a staff person's perspective on the policy issues this Congress will confront in its remaining days, and more importantly what all this might mean for the new Congress that will convene in January. I will cover three broad areas with you this morning:

(1) The current environment for legislative action in these final days of the 105th Congress;

(2) The current U.S. fiscal policy outlook -- the rewards and challenges to having a positive fiscal balance sheet; and,

(3) A quick review of the major fiscal policy issues that I conclude will confront the new 106th Congress in this new fiscal environment.

I. The Legislative Environment at the end of the 105th Congress

From my perspective, let me state what I think should be obvious --nobody knows how the current House Judiciary Committee's process will unfold over the coming weeks. And certainly, nobody knows

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exactly how that activity will impact the legislative process for the remainder of this fall and carrying over into the next Congress.

Also from the perspective of a staffer who began his government career in this town at the very time of another Presidential crisis in the Watergate years, let me also state what might not be so obvious. While nightly the national new networks flash the logo " President in crisis" -- government (the legislative, judicial, and executive branch) is not in crisis. The process is working, it may be distracted, but it is continuing to function. And in the Congress, it is doing what I believe the framers of our constitution designed it to do. (In fairness, however, it is not clear that the framers envisioned an independent counsel statute providing increased judicial branch powers, and I am certain the founding fathers never envisioned the Internet technology to speed briefs world-wide in seconds.)

Unfortunately whatever transpires over the next few weeks, I believe we are at the beginning, not the end of this process. It is now clear that rather than adjourning in a couple of weeks, the 105th Congress will return after the November elections.

Yes, the legislative process has and will slow, indeed some legislation will evolve differently and some not at all because a wounded President is not a threat to a Republican controlled Congress. Some legislative strategists might even determine it would be better to wait until next year, if they conclude the vote count will be better in the next Congress. On the other hand, a wounded President wants to heal quickly, and prove his mettle -- possibly resulting in more confrontation not less with a Republican controlled Congress.

The near term legislative victims of this current uncertain and tense environment will probably include: fast track trade legislation, U.S. funding of its quota share for the International Monetary Fund (IMF), managed health care legislation, financial and bank reform legislation, and possibly a Congressional Budget Resolution for the fiscal year which begins next week.

As one who works for the majority party in the U.S. Senate , I do not say any of this with joy or glee because I -- and I think many Senators and their staff -- were looking forward to completing action on these issues and preparing ourselves for the very serious and critical public debate leading to legislation next year in at least four major areas: Medicare, social security, inextricably linked to these two -- tax reform, and financial market reforms both domestic and international. These may still come to pass, but what was always going to be a difficult set of issues next year, will clearly be made even more difficult within an atmosphere of possible Presidential impeachment and high anxiety.

More important than the current daily headlines will be the longer lasting effects of the second Presidential crisis in the last quarter century. Will the balance of power shift away from the executive branch and to whom will it shift -- the legislative or the judicial branch? As an example, I believe the enactment of the Congressional Budget and Impoundment Control Act of 1974, which shifted greater control over fiscal policy issues from the executive to the legislative branch, was, in part, one of the early post-Watergate legislative fallouts. How that act may be affected both by the current situation as well as the environment of budget surpluses, I will discuss in the closing section of this paper.

II. The Current U.S. Fiscal Policy Outlook: Rewards and Challenges

A. The Budget Surplus for FY 1998.

Turning to more pleasant issues. Later today the Treasury Department will release their Monthly Treasury Statement, containing composite revenue and spending information through August. This official release, combined with daily tax receipt information allows analysts to predict with confidence that the federal government will record a budget surplus of nearly $70 billion for the fiscal year that will end in eight days. That surplus measured relative to the size of our economy will be about 1%. As we are reminded regularly -- this will be the first surplus since 1969. In that year a slight surplus of $3 billion representing about 0.3% of GDP was achieved. Compare that to the current year estimate of nearly 1.0%, you have to go back 40 years -- to 1957 and 1958-- to come anywhere near a budget surplus of comparable proportions.

One small but relevant point -- when that surplus was recorded in 1969 the federal government had borrowed from the public $278 billion, measured relative to the size of the economy at that time --29%. When we record this $70 billion surplus in a couple of weeks, we will have borrowed and will be in debt to the public for about $3.7 trillion -- or 45% of our economy measured on an annual basis.

So yes this is a big deal. It is one of the major accomplishments of the 105th Congress. Helped out, I might add, by previous Congresses that brought us the 1990 Budget Agreement, the 1993 Omnibus Budget Bill and of course the historic bipartisan budget agreement last year. But legislators should be modest in claiming responsibility for this feat, for after all, balance has been achieved ahead of schedule due to -- by the end of this year -- the longest peacetime expansion ever in this country.

We on the Budget Committee staff have tried to sort out who gets credit for balancing the budget -- and while this is a challenging analytical exercise fraught with assumptions -- we conclude that since 1993, Congress can claim roughly about 40 percent of the credit for reducing the deficit from what would have resulted had it not been for legislation -- the other 60 percent came simply from a growing economy, for which prudent monetary policy and Alan Greenspan probably deserve most of the credit. "Yes it was the economy -- stupid!"

B. The Politics of a Budget Surplus: The Definition of a Surplus.

Now we are engaged in the politics of a federal budget surplus. As a personal note, I have found that the politics and challenges surrounding a budget surplus forecast can be as difficult as those when we were running deficits. Nonetheless, they are more pleasant problems to deal with than those of the 1980's and early 1990's. But the issue of the budget surplus today has become one of definition and timing.

Do we have an annual surplus? From the perspective of a macro economist and budget policy analysts -- yes. Our total annual receipts of $1.7 trillion this year will exceed our total annual expenditures. And under the assumption that the economy will grow at about 2.0 % annually over the next few years, yes we will continue to have a surplus that totals nearly $520 billion over the next five years. (Table 1.1)

Do we have budget surplus that will continue into the future? From the perspective of one who has been humbled over the years by making budget projections -- only to see them miss the mark badly --I caution all -- be careful. We know that the current surplus projections assume that the 1997 budget agreement's spending limits are enforced. We know that the current surplus projections assume an economy with continued modest growth, with low inflation, low interest rates, and high employment. (Table 1.2)

But we do not know if we are at the top of a business cycle or if the surplus reflects a long-term permanent improvement. And we cannot easily answer the question of what impact -- in the words of President Clinton last week -- the biggest financial challenge facing the world in a half-century will have on economic forecasts and therefore these surplus projections. We do know, however, that if a recession were to occur similar to one in 1990 and 1991, the surplus of $520 billion over the next five years would not only be eliminated, we would be back in the red by nearly $50 billion. A swing of nearly $600 billion from surplus to deficits.[2]

Do we have an annual surplus? From the perspective of the budget lawyers, OMB Directors, and Budget Committee chairmen who are required by law to separate out of the total budget -- expenditures and receipts for the social security program and the postal service, the answer is "well not exactly." Excluding these two "off-budget" accounts the rest of the government will record a deficit of over $40 billion this year, and over the next five years will continue to record deficits totaling $140 billion. In other words, only because of an annual social security surplus this year of $100 billion and $650 billion over the next five years is there even a surplus in the overall budget.

Should we include or should we exclude the annual balances in the accounts of the social security program? The answer to that question is currently driving and will continue to drive the political debate and indirectly the fiscal policy legislation in these last few days of this Congress. This question is integral to the debate surrounding the House's Ways and Means tax bill of last week. It is also a convenient opportunity for the "wounded President" -- as he did in last Saturday's radio address -- to show his mettle "for not using the surplus until we have reformed social security first".

Do books of the federal government reflect a surplus? From the perspective of an accountant that looks at balance sheets, with liabilities funded and unfunded, assets and costs --the simple answer is we don't really know. Our U.S. Comptroller examining the government's first ever consolidated financial statement earlier this year, concluded that because the books were so bad, "we are unable to, and we do not, express an opinion on the accompanying financial statements."[3]

And finally, even with the knowledge that the social security program is running a surplus annually for the near future, it is now understood that expenditures for social security and disability insurance will

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[2] The Congressional Budget Office, September 8, 1998. Letter to Senator Frank R. Lautenberg, Ranking Member of the Senate Budget Committee.

[3] James F. Hinchman, Acting Comptroller General of the United States, B-279169; March 31, 1998.

exceed current receipts beginning in 2013, with accumulated unfunded liabilities of between $3.5 and $8.9 trillion. [4] (Table 1.3) And the on-budget Medicare trust fund will be exhausted in 2010, while recording an unfunded liability of $1.8 trillion. So these two programs alone, already have total unfunded liabilities conservatively estimated at $5.3 trillion. Note that the federal government's borrowing from the public since the beginning of the republic over 200 years ago today is $3.7 trillion. These two programs have a liability today, twice the total debt accumulated over 200 years.

The conclusion of this section: yes we will have a budget surplus for FY 1998 and very likely that surplus will continue into next year given the nature of tax receipts in FY 1999 being derived from calendar year 1998 incomes and business profits. But we are at a very uncertain time, both politically and economically in our country and in the world at large. In the recent words of Federal Reserve Chairman Alan Greenspan: "...it is just not credible that the United States can remain an oasis of prosperity unaffected by a world experiencing greatly increased stress."[5]

C. Challenges and Rewards: What to do with the surplus?

For the purposes of this discussion, if you can disregard the yellow caution flags flying, and if you assume the surplus budget projections remain unaltered -- what can we expect from policy in the near and longer term? Conventional wisdom identifies four policy outcomes evident within a balanced budget environment:

(1) the surplus could be used to reduce accumulated debt;

(2) the surplus could be used to reduce tax receipts,

(3) the surplus could be used to increase expenditures, or

(4) some combination of the three -- debt reduction, tax cuts, and spending increases.

A less conventional approach (and therefore unlikely to be used) would examine all policies that use any projected surplus against a criteria of maintaining and increasing economic growth, both domestic and international, juxtaposed up against the larger and growing unfunded liabilities the country will face outside the short-term projection window.

On the basis of what has been transpiring here in the final days of the 105th Congress, we are using the surplus in a conventional manner by some combination of the three -- tax cuts, spending increases,

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[4] Office of the Actuary, Social Security Administration, 1996. This estimate is referred to as social security's "closed-group deficiency" over the next 75 years. It includes payments to and income from current workers (age 15 and older) and retirees, but not future generations of workers. Income includes current OASDI reserve funds.

[5] Speech at the University of California, Berkley. September 4, 1998.

and debt reduction. Shortly the Congress could very likely present to the President legislation that will reduce the projected unified budget surpluses by approximately $7 billion next year, $80 billion over the next five, and $170 billion estimated over the decade. The bad news: the tax reduction legislation will have very little aggregate economic effect; the good news: the tax reduction legislation will have very little aggregate economic effect. The tax reduction legislation will reduce projected surplus in 1999 by 8.8%, the five and 10 year projection will be reduced by 15.4 % and 11.0 %, respectively.

While confusing to many, the tax reduction legislation now being considered by the Congress should not directly reduce the projected balances in the social security fund at all. Nonetheless, excluding the off-budget social security surplus from the definition of budget surpluses, it is true that the tax reduction legislation will increase the on-budget deficit by approximately 58 % over the next five years and convert an on-budget surplus of nearly $30 billion over the next 10 years into an on-budget deficit of nearly $140 billion.

But adding to the tax reduction legislation being considered in the final hours of this Congress, it is also very likely that both the President and the Congress will increase discretionary spending over and above levels agreed to in last year's budget agreement from between $10 and $15 billion on an annual basis. Technically, this increased spending would be defined as emergency spending as contemplated in the Budget Act amendments. The combination of:

(1) stringent spending caps for defense and domestic programs in 1999 and beyond,

(2) the President's unachieved goal to increase tobacco receipts dedicated to discretionary health and education spending this year,

(3) an election year,

(4) a weakened President,

(5) a Republican Congress still nervous about being accused of creating another government hiatus, and

(6) some actual emergency funding needs such as embassy security and weather related disasters in both the farm belt and coastal regions,

will probably result in far more spending out of the budget surplus that exceeds a strict definition of emergency needs. Given the nature of the statutory spending caps continuing through 2002, any increase above those caps in 1999 will have the practical effect of adjusting spending levels beyond 1999 by similar if not greater amounts -- a baseline adjustment. The result of the 1999 emergency spending increases would be to increase discretionary spending between *$50* and $60 billion over the next five years.

The conclusion: a combination of tax reductions and discretionary spending increases will result in reducing the projected federal surplus by over $140 billion over the next five years. Depending on your definition of surpluses, the unified budget surplus could be reduced by 27% from $520 billion to $380 billion by action here in the last few days of this Congress; or the projected on-budget deficit over the nest five years will be doubled from a deficit of $138 billion to $380 billion.

As I said earlier, we should all show great humility in making any of these types of projections. And as a staff person I should not pass judgement on the taxing and spending policies being considered in these final days of the 105th Congress. More important is the direction of these estimates, and that I will pass judgement on, it is unequivocal -- whatever surplus is being projected today -- it will be less once this Congress finishes its work, it will reduce the degrees of freedom available to the next Congress to deal with the fiscal challenges awaiting the country in the new millennium, and it will weaken the discipline of the current budget process that has helped to bring about the balance currently enjoyed.

III. Policy Issues for the 106th Congress.

The new Congress that will convene this coming January, the 106th Congress, will be the Congress that leads the nation into the new millennium. In February, the President will submit his budget blueprint for the Fiscal Year 2000. And during this Congress the political parties will select their candidates for the Presidential contest in November 2000. Again setting aside any prognostications related to the activities of the House Judiciary Committee and follow-on action by the House of Representatives and the Senate, how will a balanced federal budget impact the policies and legislative discussion next year?

A. Process and Procedures.

From my perspective, subtle but important changes are and will continue to evolve from this new budget environment. First and foremost, the Congressional Budget and Impoundment Control Act of 1974 came into existence at a time of growing public concern over increasing federal deficits. The Act's entire history until this year, has been clothed in an environment of budget constraint and fiscal prudence. Amendments along the way to the Act have reenforced the goal of achieving a balanced federal budget. These included the first Gramm-Rudman-Hollings (GRH) amendments setting out specific targets for achieving balance, a modified GRH in 1987 to address constitutional issues, the Budget Enforcement Act in 1990 building upon GRH with statutory spending limits on appropriations and parallel procedures for entitlement and revenue laws that added to the deficit, the ill-fated line-item veto legislation, all culminating in an extension of these procedural tools in last years Bipartisan Budget Agreement.

These tools for fiscal discipline within a deficit world, may not be appropriate in an environment of surpluses. Whether honored in the breach or blatantly disregarded, the ability to maintain budget discipline with these rules is extremely difficult in today’s surplus environment. But given the uncertainties I outlined earlier, I believe it would be unwise to abandon them completely.

One challenge that seems very evident in this new environment, is the elimination of the distinction between on-budget and off-budget surpluses or deficits. Such a change would allow for more flexibility in the Congress to utilize any unified budget surplus without confronting the contemporary argument of utilizing the social security trust fund for non social security purposes.

A second and again subtle change is underway in this new budget environment. Reducing spending or eliminating funding for a program could under certain circumstances be justified as necessary to achieve a balanced budget. Budget conscious Senators and Congressmen could argue in the 1980's that a program should not be started or should be eliminated because of enormous deficits. How do they argue now for reducing or eliminating a program if the budget is balanced and statutory caps make room for such program spending? One argument will be that there are higher priorities -- other programs should receive more or taxes should be cut. It is fortuitous that the Government Performance and Results Act of 1993 enters this scene. That legislation will put in place goals, results and measurements of performance for programs that should allow the executive, as well as authorizers and appropriators to improve the management and accountability of federal agencies and programs. The performance reports are to be issued each year with the first (for fiscal year 1999) to be issued by March 31, 2000. This will be new for many in Congress -- programs will need to be reviewed more carefully and results better determined before making claims on any surplus funds.

The time may also have come for serious rethinking of the annual budget and appropriations process. Longer term focus on issues requires more time, a precious commodity absent in a Congress with fractionated lives. Efforts next year will be made by Senator Domenici and others to to change the annual budget and appropriations process into a biennial system.

B. Fiscal Policy Legislation

The National Commission on Medicare reform, established during the 1997 Bipartisan Budget Agreement, is scheduled to report early in the new Congress. Recent reports indicate a return of double digit inflation in the health care sector. Further, the pros and cons to managed care type health systems, and the failure of the 105th to come to a successful conclusion, all guarantee that health care issues -- federal, state, and private sector -- will be back on the Congressional agenda. Congress and the public are just beginning to understand the major Medicare changes enacted in last year's budget agreement. Rather than recommending further restraints on the program's growth, to meet its unfunded liabilities, the 106th Congress could equally likely come under pressure to undo last year's savings (e.g. home health care) while also expanding benefits covered (e.g. prescription drugs).

Medicare is linked by eligibility standards to the social security program. The President has made social security reform a high priority for his final two years in office. Significant work has already been completed on a number of alternative bipartisan social security reform proposals. Major opportunities could exist in the new Congress to address social security and Medicare reform. All proposals in the end utilize the projected surplus to reform and reduce projected liabilities in the future. Experience has taught us all that reform of either program will require a committed, and dedicated executive. Social security and Medicare reform could be the first victims of the current political environment.

Not unrelated, reform to the tax code, specifically the payroll tax, and the investment of some portion of those taxes in securities -- either individually or collectively by a government entity -- could represent the most important and challenging fiscal policy issue awaiting the new Congress. Based on a proposal from Professor Martin Feldstein, establishing Social Security Investment (SI) Accounts by having workers deposit 3 percentage points of the current payroll tax into these accounts (a proposal being developed by Senators Gramm and Domenici) would have the direct effect of reducing the projected budget surplus over the next 5 years by $490 billion, and over the next decade by $1.454 trillion over the next decade. Numbers very close to the currently projected unified budget surpluses over these same time periods.

While Medicare, social security and fundamental tax reform could be high on the fiscal agenda next year, one cannot complete this survey without highlighting the other major 106 th legislative items that could place demands on any budget surplus projection:

(1) The Freedom to Farm Act of 1996 is already experiencing severe pressure for reform as international markets have crumbled and market prices declined.

(2) While not on the horizon at this time, similar to the 1996 farm legislation, if the country were to experience a recession, similar pressures would be placed on the federal government and states to loosen the spending controls adopted in the 1996 welfare reform legislation.

(3) Funding increases for national security programs (readiness and modernization) are being considered by the current Administration and will likely find a receptive audience in the new Congress.

(4) Financial institutions and banking reform is unlikely to survive the current Congress, but be early on any legislative agenda in the next. Included in this agenda surely will be a thorough and comprehensive examination of the international financial institutions and trade organizations.

(5) Environmental issues including the Administration's global warming proposals, superfund reauthorization, and endangered species act reauthorization.

(6) Education reforms will continue to dominate the next Congress as it must reauthorize the Elementary and Secondary Education Act, and

(7) Possibly overriding all fiscal policy issues early in the next Congress will be the funding needs and potential economic consequences of the year 2000 data management conversion and all the related electronic commerce, Internet, privacy and confidentiality issues that go with the new electronic age.

Finally, it is worth noting that the law authorizing the appointment of independent counsesl -- another post-Watergate reform law -- expires next year.

IV. Conclusion

It is the best of times it is the worst of times. The current fiscal outlook is one of budget surpluses growing into the next century. Major opportunities exist to use these projected surpluses to reform and modify the two major federal entitlement programs that have accumulated unfunded liabilities nearly double the current federal indebtedness, and to make fundamental changes to a tax code that has become unintelligible.

But 105th Congress will conclude in an atmosphere of uncertainty and high drama with a possible Presidential impeachment looming into next year. One-third of the world's economies are or soon will be in recession or depression, and no quick relief appears in the offing. And the other deficits: the U.S.'s current account and trade deficits will reach all time highs this year, that will help generate protectionist policies within the country.

From this staff person's perspective, I can find no direct answers for the direction public policy will take in this tumultuous environment. As my last resort , I am required to simply observe that this democratic system has survived equally challenging periods in America's past history, and I have faith that it will survive this period also better and stronger for the challenges that lie ahead in the new century.